A CONSUMER BLUEPRINT FOR FINANCIAL SERVICES REFORM IN THE 106TH CONGRESS

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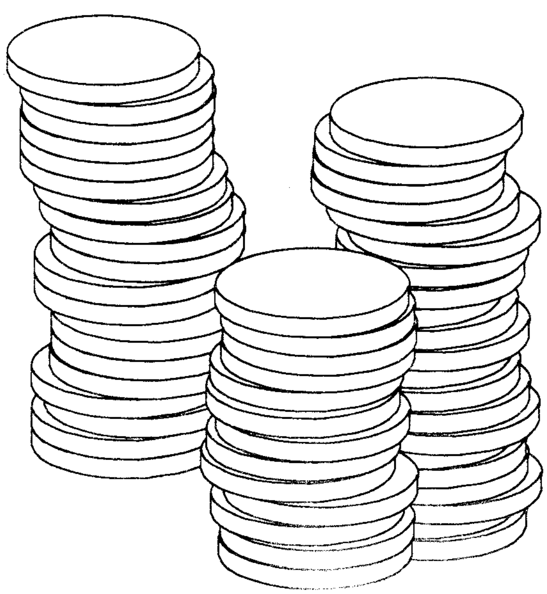

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Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about good, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports with approximately 4.5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

INTRODUCTION

In the face of rapid changes that continue to rattle through the financial services marketplace and leave consumers vulnerable to privacy invasions, rip-offs and unfair dealing, the newly elected Congress should make the overhaul of consumer finance laws a top priority. And the Clinton Administration's bank regulators must use the powers Congress gave them to protect consumers' interests. To get policymakers started, we at Consumers Union, the non-profit publisher of *Consumer Reports* magazine, have bundled our ideas for change in *"A Consumer Blueprint for Financial Services Reform"*.

Consumers Union believes it is time for Congress and regulators to take a hard look at the way the banking industry, the financial services industry and the lending industry do business, and make certain that consumer protection laws are keeping up with the rapid changes in the industry. Too often policymakers put the interests of industry ahead of the interest of consumers. It is time for our public officials to step up to the plate to ensure that all consumers, not just the wealthiest, are served adequately and fairly by our financial institutions. Consumer finance laws cry out for an update, so consumers can enter the next millennium secure in the knowledge that a new era has arrived in Washington and personal finance issues are finally going to get the attention they deserve.

The following "Eight Principles" of what consumers need in a rapidly changing market form the foundation for this consumer agenda. *Consumers Union believes consumers need:*

1. a fair, efficient and affordable method for cashing or depositing checks, making payments and savings;
2. fiscally sound and liquid providers of financial services;
3. reasonable limits on the amount of risk that consumers must undertake, and clear, meaningful disclosure of the risk associated with different financial service products;
4. meaningful shopping choices including simple and understandable pricing and products, and useful disclosure;
5. access to credit at affordable rates;
6. financial privacy;
7. accessible and responsive federal and state regulators; and
8. a just, equitable and widely available system of financial services.

This blueprint is presented in a format that identifies the problem and the solution in ten subject areas that require the attention of Congress and the Clinton Administration. This *"Consumer Blueprint"* brings together innovative pro-consumer ideas in three categories:

- restructuring financial services to meet consumers needs;
- assessing the impact of mergers on consumers; and
- making the lending industry accountable.

STEP ONE: RESTRUCTURE FINANCIAL SERVICES TO MEET CONSUMERS' NEEDS

PRIVACY

THE PROBLEM:

Financial firms have become masters at the marketing frenzy of seeking out new customers, invading our mailboxes and telephone lines with abandon and almost no checks on their practices. Consumers have few privacy protections in the law, either for traditional "paper-based" transactions or the new world of "e-commerce." As banks, insurers and investment firms merge into huge "money centers," the risk of confidential customer information being shared or sold without the consumer's knowledge or consent becomes great.

THE SOLUTION:

Update Privacy Laws Now: Start by closing loopholes and exemptions in the Fair Credit Reporting Act. Hard fought reforms that took effect in 1997 to provide consumers with some limited control over how credit bureaus use databanks of personal information for commercial marketing purposes are proving to be deficient because of serious gaps in the law.

The credit industry actively uses these loopholes to evade the will of Congress by allowing affiliates to share information between themselves without restriction if they can document that once upon a time the customer got a limited opportunity to "opt-out" of this practice. Besides your name, address and phone, these lucrative data pools can also contain details about consumers' financial transactions – such as whether they recently got a mortgage or a loan – since these kinds of details are completely exempt from the 1997 reforms. Congress should:

- act quickly to close off these hidden avenues to our financial records and personal data;
- change the opt-out feature of the law to an "opt-in" opportunity, which ensures consumers control over how and when personal information is shared;
- give consumers the power to determine what information the institutions hold on them and what their rights are; and

- obligate banks and other financial firms to protect the confidentiality of customers' financial and personal information and hold these institutions legally responsible when a bank or other financial firm violates the confidentiality standards because of a breakdown or failure to protect the data.

DECEPTIVE & MISLEADING SALES PRACTICES

THE PROBLEM:

Banks tout their entry into the insurance and investment world as a boon for consumers but studies indicate it could just as easily be a bust for consumers who are misled about whether the products banks sell are FDIC-insured or otherwise guaranteed. Banks still don't have to comply with the full panoply of investor protection rules that apply to registered securities brokers, including the ability to recover losses through the securities arbitration process.

THE SOLUTION:

Consumers need protections in the area of bank retail sales. To help prevent confusion and coercion, consumers need:

- effective disclosure of which products banks sell are not FDIC-insured or guaranteed and subject to risk of loss;
- requirement that sales activities must be conducted in an area separate from where banks take deposits and make loans;
- anti-coercion rules that prohibit banks from taking advantage of loan applicants by having sales people wait to make sales until after the loan is made;
- suitability rules to ensure the products consumers purchase meet their financial needs, not the profit-maximizing goals of the salespeople seeking higher commissions;
- a process for consumers who lose money when banks violate these rules to recover their losses; and
- repeal of banks' immunity from securities laws so investors have the same protections regardless of where they purchase investments.

GUARDING THE SAFETY & SOUNDNESS OF OUR BANKING SYSTEM

THE PROBLEM:

The "too-big-to-fail" doctrine puts taxpayers on the hook if these mega-institutions move into riskier activities that up until now have not been underwritten by the U.S. taxpayers. The hedge fund fiasco should give us pause about dangers ahead.

THE SOLUTION:

Minimize Taxpayer Risk. Risky activities, such as insurance and securities underwriting, should only be permitted in separately capitalized affiliates, in which the parent holding company separates the bank from the other financial firm, to reduce the risk of loss to the banks from these activities. In addition, appropriate bank supervision, regulation and "firewalls" are needed to prevent risk to the deposit insurance system.

Keep Banks and Commercial Firms Separate. The longstanding separation between banks and the commercial firms to which they supply credit should remain intact. The problems in Asia highlight the need to keep the sources of credit separate from the companies that need credit. When large commercial firms owned by banks in Asia and elsewhere became insolvent, the government and taxpayers had to support the banking system that suffered staggering losses from the bankrupt firms.

STEP TWO: MAKE MERGERS RESPONSIVE TO CONSUMERS, NOT JUST SHAREHOLDERS

The Explosion of Mergers: Banks

THE PROBLEM:

Merging banks have been extremely vague about the real impact of their mergers, leaving consumers and communities largely in the dark about whether they truly meet the legal standard of meeting the "convenience and needs of the community." Experience with branch closings and fee increases after recent mergers leave consumers at risk of receiving reduced services, higher prices, less community-oriented spirit and worse access to banking services for low and moderate income consumers.

The rush by regulators to approve large bank mergers has occurred with virtually no public input. Several different mergers with nationwide implications and impacts had *only one* public hearing. Two of the bank mergers approved in 1998 total $1.267 trillion in assets, yet the Federal Reserve held *just one* public hearing on each of these mergers.

> From 1980 to 1997, not counting 1998's extraordinarily large mergers, there were 7,211 bank mergers and $1.8 trillion in assets acquired. In nominal dollars, the ten largest U.S. banks held more than double the volume of assets in 1997 as the top ten in 1990. The top 100 U.S. banks have increased their share of U.S. assets held from 51 percent in 1980 to 74.6 percent in 1997.

In addition, too little attention is being paid to the impact of mergers on the two tier financial system, where often lower income consumers get higher prices and lower quality products.

The federal merger guidelines assume that each merger can increase concentration by a preset, measurable amount without harm to the marketplace. However, when mergers are rapid, assumptions that any merger has minimal impact can overlook the cumulative effect of these mergers on the marketplace.

THE SOLUTION:

Unless the Clinton Administration officials become responsive to consumers needs, the 106th Congress should take **four steps** to assure mergers are responsive to consumers, not just shareholders:

- **Reconsider the standard used by regulatory agencies for evaluating bank mergers.** There is little justification for assuming that any merger is without competitive effects in such a rapidly consolidating market.

> Under the merger guidelines as applied to banks, mergers that increase the concentration index by less than 200 points in a moderately concentrated market or 100 points in a highly concentrated market are considered "unlikely to have adverse competitive consequences and ordinarily require no further analysis." (*Horizontal Merger Guidelines*, Dept. of Justice, section 1.5, with application of doubling rule for bank mergers.) The effect of this "free bite" can be severe when there are multiple large mergers occurring in a market in a short period of time. California, for example, had 32 bank mergers in 1996 and 1997 alone.

- Require the federal regulatory agencies to hold **comprehensive public hearings** in multiple affected cities reviewing all aspects of how the "convenience and needs of the community" will be served by the merger before considering whether to approve additional mega-mergers.

- **Investigate the emerging two-tier financial structure in the US banking system and ensure all consumers, not just the wealthiest, are served adequately and fairly by our financial institutions**. Congress and the regulators should examine marketing practices, new fees, the lack of focused and effective programs to reach lower-income consumers and sub-prime lending abuse.

- Encourage regulators to require multi-state merging banks to make **specific, enforceable commitments** to states and localities for future community reinvestment activities as a condition of merger approval.

The Explosion of Bank Mergers: The Financial Services Industry

THE PROBLEM:

The Community Reinvestment Act (CRA) has resulted in demonstrable benefits to low and moderate income communities: credit has been extended for affordable, locally managed housing, first time homebuyers, and targeted small business and other community development purposes. According to the Federal Financial Institutions Examination Council (FFEIC), community development loans nationwide totaled $18.6 billion for 1997.

Despite these positive benefits to communities this public law has been under attack in Congress and lacks the vigorous support from regulators it warrants. Recent CRA announcements by major multi-state banks have lacked specific targeting and commitments to ensure that loans counted for CRA purposes in fact deliver new economic stimulus to low- and moderate-income communities.

> *The federal banking agencies' willingness to approve multi-state bank mergers – the market has experienced 121 of these from 1980-97 – without strong, specific, and enforceable CRA commitments to particular states and regions places the value of CRA at risk.*

One of the original justifications for the law was the participation of the federal government in assuring the continued solvency of the banking system. As banks begin to own more non-bank affiliates, and the businesses of banking, insurance and securities become more similar, the line between covered and uncovered activities becomes arbitrary.

Insurance companies in particular have had a less than stellar record of serving the needs of low-income and minority communities. Studies indicate redlining of these areas takes place in the form of refusing to write insurance, selling at higher prices or selling inferior insurance products. Nationwide was recently slapped with a $100 million judgement for refusing to sell policies in minority neighborhoods.

THE SOLUTION:

As insurance companies and securities firms merge with depository institutions, they should come under obligations similar to the federal Community Reinvestment Act and other obligations of the type applied to banks to ensure they too meet the needs of all communities, not just the wealthiest. The insurance and securities industries must be held to account for unfair and discriminatory dealing. The trillions in assets they hold should be put to work to assure the communities where they do business stay vibrant and working. To meet this goal, Congress should look toward three tactics:

- **Disclosure**. Require insurance and securities firms to disclose where they are selling their products and making investments – the same way banks keep the public informed. To aid this effort, Congress should direct the General Accounting Office (GAO) to examine the amount and percentages of insurer investments that serve low- and moderate-income communities, and measure the volume of these insurance activities with banks of comparable size.

- **Link public obligations to new merger approvals.** A clear message also must be sent to federal banking regulators that further bank mergers should not be approved without definite, measurable, enforceable commitments of the merger candidates to meet the needs of ALL communities. Such commitments need enforcement and specific geographic and product targeting to produce jobs, home ownership, and economic growth in disadvantaged neighborhoods and for disadvantaged consumers.

- **Fortify the law, don't narrow it**. As efforts get underway to fortify the Community Reinvestment Act, Congress should firmly reject any efforts to narrow its application.

Increased Fees & More Junk Fees

THE PROBLEM:

The proliferation of new fees makes it harder for consumers to comparison shop for the lowest-priced account. In March 1996 *Consumer Reports* found banks across the country charging more than 100 different fees on checking and savings accounts. In

Congressional testimony in February, 1997 Stephen Brobeck of the Consumer Federation of America stated that one expert had identified 200 fees that banks could charge on deposit accounts.

THE SOLUTION:

- **Require all depository institutions to offer low-cost deposit accounts** as one of the provisions of any financial modernization bill. Congress also should carefully supervise the Treasury Department's handling of EFT'99 to ensure that the voluntary electronic transfer account is the beginning, and not the end, of efforts to promote low-cost banking services. Congress also should clarify that federal law does not preempt state regulation of bank fees imposed on a state's residents.

- **Begin a comprehensive effort to reduce the proliferation of junk fees** by directing the General Accounting Office to issue a long overdue report on the problem. The GAO should be asked to determine the prevalence of junk fees, how the amounts charged for these fees compare to the costs of providing the services, whether the market is providing adequate controls on bank fees and what measures should be implemented to ensure access to affordable bank services. (The GAO last studied bank fees generally in 1987.)

THIRD: MAKE THE LENDING INDUSTRY ACCOUNTABLE

High Cost Sub-prime Lending

THE PROBLEM:

More price competition and better products are needed for low- and moderate-income borrowers, including for borrowers with less-than-perfect credit. The explosion of the sub-prime lending industry has provided new sources of credit for consumers with imperfect credit histories, but also new players eager to sell high-cost credit to overextended consumers.

- The share of new sub-prime mortgages jumped from 5 percent to 15 percent and from $50 to $125 billion dollars between 1994 and 1997. (August 1998, *National Mortgage News*)
- Of the $859 billion in new mortgages last year, $125 billion were sub-prime.
- Outstanding sub-prime auto loans range between $75 and $100 billion, or about 20 percent of all outstanding auto loans.
- Industry sources estimate that 10 percent of all new car loans are sub-prime.

At the same time of this explosion in the sub-prime market, a recent industry study shows that 38 percent of one major bank's low-income borrowers had credit scores above 720. Even when low-income borrowers have good credit records, often it is only the high-cost providers who actively market to them.

THE SOLUTION:

Assure that low-income borrowers are not relegated to the sub-prime market by beefing up scrutiny of traditional bank and thrift lenders.

All financial institutions need **effective initiatives to place each borrower in the credit product with the best terms for which that borrower qualifies**. Each bank involved in sub-prime lending should be required to maintain an effective program to refer qualified applicants from the higher cost finance company to lower cost bank credit. *Absence of such a program should be strong evidence of a fair lending violation.*

Mortgage Lending

THE PROBLEM:

The current mortgage process is overly complex and can be confusing to consumers, who face many traps when they make what is usually the biggest transaction of their lives – buying a home.

Loopholes in current law make it very difficult for homebuyers to protect their pocketbook when they shop for a home and all the related services necessary to finance and settle the deal. Consumers get critical information too late in the process. Disclosures about the cost of the loan are typically made only after the prospective homeowner pays an application fee, which can amount to hundreds of dollars. Even after the terms are disclosed they are not firm until closing.

Once in their homes, consumers get abused through predatory lending practices on home equity loans, such as:

Equity Stripping: a lender may base a loan solely on the equity in a home, not on an ability to repay the loan. This type of lending is dangerous, especially for the elderly who have built up equity in their homes, but may live on a fixed income.

Packing: many consumers seeking these loans may have few other choices. Extra costs may be built in, i.e., credit insurance, for items that the consumer does not need;

Flipping: multiple refinancing of loans with no benefit to the consumer. This often occurs when the original loan may have also been abusive; and

Home Improvement Scams: an area ripe for consumer rip-offs.

THE SOLUTION:

Legislation is needed to ensure consumers have:

- timely and adequate information to make informed decisions about the home buying and financing process;
- basic cost and related information before putting hundreds of dollars on the line; and
- guaranteed settlement service costs and note rate good from the time of application through closing.

Congress should act to make sure consumers have effective protections against fraud, deception and unfair predatory lending practices through:

- pressuring agencies for continued enforcement against unfair and deceptive lending practices;
- eliminating incentives for repeat refinancings or "flipping;"
- enacting protections against home equity scams;
- expanding foreclosure mitigation practices to help consumers keep their homes;
- preserving the prohibition of illegal kickbacks to mortgage brokers.

Consumer Credit

THE PROBLEM:

For American consumers, credit card debt alone has doubled in just four years. At the end of 1997 there was $422 billion of credit card loans outstanding. Three out of five American households carry credit card debt of $7,000 or above.

The credit industry encourages people to carry large loads of consumer debt with a multitude of aggressive tactics that are irresponsible:

- **increasing number of solicitations:**
  The marketing of credit cards has been relentless and abusive: there are over a billion cards in circulation -- a dozen credit cards for every household in the country. And over 3 billion solicitations a year, more than 41 mailings to every household.

- **encouraging minimum payments that do not pay down the loan:**
  Currently, credit card statements, unlike mortgage loans and car loans, do not disclose the amortization rates or the total interest that will be paid if the cardholder makes only the minimum monthly payment. Using a typical minimum monthly payment rate on a credit card, it would take 34 years to pay off a $2,500 loan, and total payments would exceed 300 percent of the original principle.

- **offering large credit lines to students and minors with little or no income:**
  Direct solicitation to both college and high school students has intensified. Cards are available to almost any student – no income, no credit history and no parental signature required.

- **penalizing consumers who pay off their balances:**
  Several companies have instituted charges or even canceled credit cards for customers who pay in full each month, preferring customers with large credit balances who pay minimum monthly payments.

- **stuffing our mailboxes with dangerous LIVE checks:**
  Often consumers who cash these checks end up paying exorbitant fees under hidden loan terms. LIVE checks can also cause consumers financial worry if they are lost or stolen.

- **offering misleading "teaser" rates of interest.**
  Teaser rates are designed to encourage consumers to run up balances when the rate is low, but often the balances will inevitably be paid back at a much higher rate or hidden terms, such as one late payment, triggering higher rates.

THE SOLUTION:

Legislation is needed to ensure consumers have adequate information about their choices with respect to consumer credit, responsible debtors are not penalized, and minors are protected. Measures must be put in place to:

- Make it easier to get off credit card mailing lists.
- Enhance disclosures to consumers about the consequences of making minimum payments.
- Prohibit penalties or card cancellations for consumers who pay the full balance owed on a credit card in any month.
- Ensure that no credit cards are provided to minors unless a parent or other adult cosigns or can demonstrate a source of income.
- Outlaw live checks.
- Enhance disclosure concerning "teaser" rates.

Electronic Funds Transfer '99

THE PROBLEM:

Implementation of the 1996 law requiring that all federal payments, including social security, welfare, and other federal benefits, be made electronically has stirred enormous confusion and concern. Unless a waiver is obtained, all recipients of federal benefits must obtain some type of account into which their checks can be electronically deposited beginning on January 1, 1999.

By dragging its feet on putting standards in place to govern these accounts, the Department of Treasury has left the door open for fringe financial service providers to enter the market and siphon off fees. Questionable partnerships between fringe bankers, such as check cashiers, and banks to take advantage of the law need prompt congressional oversight and review.

THE SOLUTION:

Consumers who elect to receive their benefits this way should receive fair and reasonable services and some added benefit of convenience. Moreover, a significant number of the 12 million households who do not maintain a bank account could be lifted into the financial mainstream if EFT '99 spurs them to get a bank account.

Congress must get involved now to shape this future. It should:

- Pressure the Treasury Department to require that fees charged for these new accounts are reasonable and that consumer protections apply to the transactions.

- Ensure third parties, such as community centers, the post office, and grocery stores are encouraged to service these accounts so those who do not open bank accounts are well served.

The dawning of the EFT '99 issue also creates a public obligation for Congress to assure that consumers have access to low cost deposit accounts. The beneficiaries?

-- 12 million households going without deposit accounts altogether, who stand to benefit from such a proposal.

-- 48 million households who keep less than a thousand dollars in their checking accounts and can be trapped in a never-ending cycle of fees.